[4] The meaning of the provisions can be ascertained. Therefore they may be relied upon.

[*Appeal dismissed with costs*].

Cases referred to:
Law v. Local Board of Redditch [1892] 1 QB 127 at p. 133 ***(refd)***
Dunlop Pneumatic Tyre Co. Ltd. v. New Garage & Motor Co. [1915] AC 79, at p. 86 ***(refd)***
AMEV UDC Finance Ltd. v. Austin [1986] 162 CLR 170 ***(refd)***
Esanda Finance Corporation Ltd. v. Plessnig [1989] ALJ 238 ***(refd)***
Elsey v. J.G. Collins Insurance Agencies Ltd. [1978] 83 DLRI at p. 15 ***(refd)***
Robophone Facilities Ltd. v. Blank [1966] 1 WLR 1428 p. 1447 ***(refd)***
Ariston SRL v. Charly Records Ltd. [1990] The Independent 13th April 1990 ***(refd)***

Other soources referred to:
Law Commission Working Paper No. 61, Penalty Clauses and Forfeiture of Monies Paid, p. 30
The Rise and Fall of Freedom of Contract by Atiyah, [1979] Edn., Cap. 22

JUDGMENT

Lord Woolf:
This appeal, from the decision of the Court of Appeal of Hong Kong of 24 April 1991, with the leave of that Court, raises the issue as to the approach which the Courts should adopt in determining whether a clause in a commercial contract is unenforceable as being penal in effect.

The decision was given in proceedings commenced by Philips Hong Kong Limited ("Philips") by originating summons. The purpose was to obtain a ruling of the Hong Kong High Court upon the provisions contained in a contract which Philips had entered into with the Government of Hong Kong in connection with the construction of a highway project known as "Route 5" between Tsuen Wan and Sha Tin. The contract contained an arbitration clause and the present proceedings were initiated by Philips to obtain the ruling of the Court on preliminary issues prior to arbitration. In the High Court Mr. Justice Mayo found in favour of Philips and on their application declared in effect that:

(i) the sums set out in an Appendix to a contract made under seal dated 24 November 1986 between the plaintiff and the Government of Hong Kong, the reference of which is Contract No. HY/85/09, (hereinafter referred to as "the Philips Contract" as the amount of liquidated damages for delay, when operated in conjunction with clause 29 of its Conditions) were capable of operating as a penalty;
(ii) Clause 29 was void for uncertainty and unenforceable;
(iii) the plaintiff was under no liability to pay or allow to the defendant any sum as liquidated damages for delay to completion of any part of the contract works.

However the Court of Appeal allowed the Government's appeal, quashed the declarations granted by Mayo J. and gave Philips leave to appeal.

The nature of the Philips contract:

The contract works included the design, supply, testing, delivery, installation and commissioning of a processor based supervisory system for the approach roads and twin tube tunnels which were to be constructed under Smuggler's Ridge and Needle Hill Mountains in the New Territories as part of the Shing Mun Section of the project.

Instead of adopting the more usual course of employing a main contractor with overall responsibility for constructing the Shing Mun Section and allowing the main contractor to sub-contract portions of the contract, the Government entered directly into a total of seven separate contracts, the designated contracts, including the Philips contract. By dealing directly with the contractors the Government was seeking to exercise greater control over the whole project than would be possible under a single overall contract. The total value of the seven contracts was over HK$649 million while the Philips contract alone involved over HK$51 million. The Philips contract was contained in four books and included a substantial number of standard provisions used by the Government on other projects.

Apart from contract HY/85/07 which dealt with landscaping, each of the contracts, which were described as the designated contracts contained its own individual programme for the progress of the work in the form of a flow chart. Each of the designated contracts also contained the flow charts setting out the

programmes which the other contractors were required to meet. Each of the contractors should therefore have been aware of the activities on which the other contractors would be engaged at each stage of their work and the possible consequences of delay on the part of one contractor on the other contractors.

The flow charts identified as Key Dates interfaces with other contracts. Key Dates were dates which a contractor was under an obligation to meet so as to enable other contractors to continue with their work unimpeded. If those dates were not met by a contractor, then the contract specified a liability to pay liquidated damages to the Government at a daily rate. In addition the whole of the contract work was required to be completed within a specified time and, if this was not met, the contract provided that the contractor was required to pay additional liquidated damages also at a daily rate.

The Target Dates were those dates which a contractor should aim to meet in order to complete its contractual obligations on time. However if the Target Dates were not met no contractual liability would arise so long as the total works were completed on time.

In the case of the Philips contract, the works were to commence on the date to be notified by week 36 by the engineer and had to be completed by week 195 (a period of 160 weeks). The amount of liquidated damages which was payable for not completing the whole of the works within the specified time was HK$74,104 per day, a figure set out in the Appendix to the Form of Tender. That Appendix also specified the amount of the liquidated damages for delay in meeting Key Dates. The amount stated varied according to the section of the works to which they related, the sum increasing according to the number of other contractors who could be affected by the delay. Thus for the ten Key Dates identified in the flow chart the daily rate of liquidated damages was a figure which varied between HK$60,655 per day and HK$77,818 per day. The lowest figure, as would be expected, related to the first Key Date. The second lowest figure (HK$60,665) was payable in the case of six of the Key Dates where only one other contractor would be affected by delay. In the case of one Key Date two contractors could be affected and the sum payable was HK$62,568 per day; in the case of another Key Date three contractors would be affected and the rate was HK$73,017 per day. Finally there was one Key Date which would affect four contractors and the sum payable was HK$77,818 per day. While the flow charts were stated to be for "guidance only", the contract also included a schedule in Appendix 2 to the Particular Specification of the Contract which detailed the "parts of the Works that are required to be complete to a specified degree by either a Key or Target Date as indicated" (clause 1.11). The Particular Specification also expressly provided that Key Dates "are subject to liquidated damages in accordance with clause 29 of the Conditions of Contract" (clause 1.10(b). That clause provides:

> 29. LIQUIDATED DAMAGES FOR DELAY
>
> 29.1 If the Contractor shall fail to complete the Works or any Section thereof or shall fail to achieve a Specified Degree of Completion within the time prescribed by Clause 27 or extended time, or shall fail to complete or shall unduly delay the Tests on Completion then the Contractor shall pay to the Employer the sum or sums stated in the Appendix to the Form of Tender as liquidated damages for such default and not as a penalty for every day or part of a day which shall elapse between the time prescribed by clause 27 or extended time, as the case may be, and the date of completion of the Works or the relevant Section thereof or the relevant Specified Degree of Completion.
>
> 29.2 The Employer may, without prejudice to any other method of recovery, deduct the amount of such damages from any monies due or which may become due to the Contractor whether under this or any other Contract with the Employer.
>
> 29.3 The payment or deduction of such damages shall not relieve the Contractor from his obligation to complete the Works or from any other of his obligations and liabilities under the Contract.
>
> 29.4 If before completion of the Works, any Section of the Works is required by the Employer and capable of occupation or use by the Employer and has been confirmed by the Engineer as completed pursuant to clause 31 (Taking Over), the liquidated damages (if any) prescribed for delay to the whole of the Works shall for any period of delay after such certification be reduced in the proportion which the value of the Section so certified bears to the whole of the Works:

> Provided that -...
>
> Notwithstanding any provisions of this Clause or of the Contract providing for the reduction in liquidated damages for the early completion of any Section of the Works the resulting amount of liquidated damages shall not be less than the minimum amount of liquidated damages as stated is (sic) the Form of Tender.

The word "Works" in 29.1 and 29.4 is defined as meaning "all Equipment to be provided and work to be done by the Contractor under the Contract". It will be observed that clause 27 is referred to in clause 29.1. This clause contains the express obligations of Philips to complete the entire works and by the Key Dates sections of the work (which include the Portions of the Work identified in the schedule). There is also a reference in clause 29.1 to "extended time". The circumstances in which Philips would be entitled to an extension of time for completion are dealt with in clause 28. It is not necessary to refer to the terms of the proviso to clause 29.4 which are complex and not easy to interpret, as the argument of Philips that clause 29.4 could apply to the work which they were required to perform is rejected. For clause 29.4 and its proviso to be relevant a section of the works had to be "capable of occupation or use by the Employer" and "confirmed by the Engineer as completed pursuant to clause 31" as stated in clause 29.4. As is apparent from the descriptions of the different sections of the Work in the schedule of Key and Target Dates none of the work was of a kind which in ordinary parlance was capable of "occupation" or "use" by the Government prior to completion. Nor had it been "confirmed by the Engineer as completed" in accordance with the Key Dates to enable other contractors to carry out their work under their parallel contracts.

The Judgments of Mr. Justice Mayo and the Court of Appeal.

In his judgment Mr. Justice Mayo acknowledged that in preparing the Philips contract it was "evident that a considerable amount of time and energy had been expended by (the Government) in attempting to quantify losses which would be occasioned if (key) dates are not met" and that he was "by no means satisfied that this approach to the drafting of clause 29 necessarily leads to a conclusion that damages payable under the clause constitute a penalty". However having examined the drafting in some detail he concluded that the provisions of clause 29 were penal in effect. In coming to this conclusion he followed a decision of Sears J. in *Arnhold v. A.G.* [1989] Construction Law Journal 263. Mr. Justice Sears, in respect of a clause drafted in virtually identical terms to clause 29, came to the conclusion that the sum payable under that clause was a penalty because although the clause provides for the amount payable to reduce as work is completed it prevents the amount of liquidated damages being reduced below a minimum specified in the Form of Tender. Sears J. came to this conclusion since he considered that, if the clause had been a genuine pre-estimate of the anticipated loss, the figure payable under clause 29 if the works were not completed on time should "ultimately decrease to zero" but because of the operation of the minimum figure, there could be circumstances where a contractor would be liable to pay "a figure higher than what could possibly be a genuine pre-estimate of the anticipated loss". Mr. Justice Mayo also accepted Philips' argument that since there were situations in which clause 29(4) could apply the provisions were penal because of the illogical consequences which might follow if this happened.

The Court of Appeal allowed the appeal, quashed the declaration and granted the Government costs in both Courts. The Court of Appeal did so on the grounds that there could be no application of clause 29.4 to this contract, a view (as already indicated) with which their Lordships are in agreement. Having come to that conclusion the Court of Appeal found that the matters relied upon by Philips before Mayo J., as demonstrating that the provisions ostensibly providing for liquidated damages in reality constituted a penalty, "fell away". The Court of Appeal did not deal, however, with such arguments as may have been advanced before them on behalf of Philips which were not based on clause 29.4.

The consequences of Philips' approach to determining whether a provision in a contract as to liquidated damages is unenforceable.

In these proceedings Philips are seeking to obtain no more than a ruling of the Courts as to the legal position under the contract. They

reserve the right to investigate the question as to whether the amount claimed is in fact excessive at the arbitration when the evidence can be fully investigated. Their Lordships have reservations as to the propriety and the practicality of Philips doing this. It appears to their Lordships that their decision on the appeal could determine finally whether Philips have or do not have a defence on the basis of the alleged penal effect of clause 29. However their Lordships have not been asked to express any final conclusion as to this and therefore do not do so.

At this stage Mr. Nicholas Dennys QC does not suggest on behalf of Philips that the sum claimed by the Government by way of liquidated damages is in fact exorbitant in view of the very substantial delay which in fact occurred in the execution of this contract by Philips. Instead he bases his argument on what could have happened in a number of different hypothetical situations. He suggests that if one or more of those situations had happened, the sum which would then be payable by way of liquidated damages would be wholly out of proportion to any loss which the Government was likely to suffer in that situation and that this is sufficient to establish that the provisions are penal in effect. If Philips' approach is correct this would be unsatisfactory. It would mean that it would be extremely difficult to devise any provision for the payment of liquidated damages in the case of a contract of this sort which would not be open to attack as being penal. As is the case with most commercial contracts, there is always going to be a variety of different situations in which damage can occur and even though long and detailed provisions are contained in a contract it will often be virtually impossible to anticipate accurately and provide for all the possible scenarios. Whatever the degree of care exercised by the draftsman it will still be almost inevitable that an ingenious argument can be developed for saying that in a particular hypothetical situation a substantially higher sum will be recovered than would be recoverable if the plaintiff was required to prove his actual loss in that situation. Such a result would undermine the whole purpose of parties to a contract being able to agree beforehand what damages are to be recoverable in the event of a breach of contract. This would not be in the interest of either of the parties to the contract since it is to their advantage that they should be able to know with a reasonable degree of certainty the extent of their liability and the risks which they run as a result of entering into the contract. This is particularly true in the case of building and engineering contracts. In the case of those contracts provision for liquidated damages should enable the employer to know the extent to which he is protected in the event of the contractor failing to perform his obligations.

As for the contractor, by agreeing to a provision for liquidated damages, he is seeking to remove the uncertainty as to the extent of his liability under the contract if he is unable to comply with his contractual obligations. That he may be unable to comply with those obligations is always a risk which a contractor has to face and there are substantial advantages from his point of view in being able to quantify accurately the amount of his liability if matters do not proceed according to plan. As Mr. Richard Fernyhough QC submitted, the liquidated damages clause enables the contractor when quoting for a contract to take account of the possible liability which he may be under in determining a price which he quotes for undertaking the contract, particularly where the amount of loss actually suffered by the employer will be difficult to quantify. It therefore makes commercial sense for both sides of the contract to remove the uncertainty by including a liquidated damages clause in the contract. However this will only be the result if the inclusion of a clause providing for liquidated damages will reduce and not increase the risk of a dispute and possible litigation in the event of the contractor failing to fulfil his contractual obligations.

What then is the position? Is it sufficient for a contractor to identify hypothetical situations where the effect of the application of the clause may be to produce a sum payable to the employer substantially in excess of the damage which the employer is likely to suffer in order to defeat the intended effect of a clause freely entered into by the parties providing for the payment of liquidated damages?

The Court's approach to liquidated damages provisions in contracts.

Although there is a good deal of disagreement as to how the penalty jurisdiction grew up (see the Law Commission Working Paper No. 61,

Penalty Clauses and Forfeiture of Monies Paid) it is recorded in the judgment of Kay LJ in *Law v. Local Board of Redditch* [1892] 1 QB 127 at p. 133 that originally it was by the Courts of Equity that relief was granted. They did so where a sum of money was agreed to be paid as a penalty for non-performance of a collateral contract where the actual damage which would be sustained could be estimated. In such circumstances the Courts would limit the sum recoverable to the actual loss suffered. The principle would be applied in particular where the penalty was agreed to be paid for the non-payment of a sum of money under a bond. This limited application of the principle was subsequently extended to other situations by the Courts of common law, but the principle was always recognised as being subject to fairly narrow constraints and the Courts have always avoided claiming that they have any general jurisdiction to rewrite the contracts that the parties have made.

Guidance as to what are the constraints is authoritatively set out in the speech of Lord Dunedin in *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage & Motor Co.* [1915] AC 79, at p. 86, when he said:

> ... I shall content myself with stating succinctly the various propositions which I think are deducible from the decisions which rank as authoritative:
>
> 1. Though the parties to a contract who use the words 'penalty' or 'liquidated damages' may *prima facie* be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found *passim* in nearly every case.
> 2. The essence of a penalty is a payment of money stipulated as *in terrorem* of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage *(Clydebank Engineering and Shipbuilding Co. v. Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6).
> 3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach (*Public Works Commissioner v. Hills* [1906] AC 368 and *Webster v. Bosanquet* [1912] AC 394).
> 4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:
>
> (a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach. (Illustration given by Lord Halsbury in *Clydesbank* case [1905] AC 6.
>
> (b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid (*Kemble v. Farren* 6 Bing. 141.) ...
>
> (c) There is a presumption (but no more) that it is penalty when 'a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage' (Lord Watson in *Lord Elphinstone v. Monkland Iron and Coal Co.* 11 App. Cas. 332 .
>
> On the other hand:
>
> (d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties (*Clydebank case,* Lord Halsbury [1905] AC at p. 11; *Webster v. Bosanquet,* Lord Mersey [1912] AC at p. 398).

Lord Denning did criticise this restricted view of the application of the principle in *Bridge v. Campbell Discount Co.* [1962] AC 600 at p. 629, but his views were not shared by the other members of the House. Furthermore although Lord Denning stressed the equitable nature of the Courts' powers, the main subject of his strictures was the conclusion that, if a hirer under a hire purchase agreement lawfully terminated the agreement, he would not be able to say the sum then payable by him according to the terms of the agreement was a penalty, but he would be able to do so in respect of the very same term if the agreement was terminated in consequence of his breach of contract. This he understandably described as the "absurd paradox".

That "paradox" does not arise for consideration on this appeal. It was however considered by the High Court of Australia in *AMEV UDC Finance Ltd. v. Austin* [1986] 162 CLR 170, a case to which reference is made, not for its treatment of that subject but for the general approach which was adopted as to what should be the approach of the Court to alleged penalties. It was a case in which a finance company tried unsuccessfully to rely on general equitable principles relating to relief against penalties as against guarantors of a hirer when the finance company had determined a hiring agreement. Mason and Wilson JJ. in a joint judgment, having admirably surveyed the decisions as to penalties decided both in this country and in other Commonwealth countries, referred to the advantages of allowing the parties to contracts greater latitude to determine for themselves the consequences of breaches or the termination of their contracts, and then went on to say (p. 193):

> But equity and the common law have long maintained a supervisory jurisdiction, not to rewrite contracts imprudently made, but to relieve against provisions which are so unconscionable or oppressive that their nature is penal rather than compensatory. The test to be applied in drawing that distinction is one of degree and will depend on a number of circumstances, including (1) the degree of disproportion between the stipulated sum and the loss likely to be suffered by the plaintiff, a factor relevant to the oppressiveness of the term to the defendant, and (2) the nature of the relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term. The Courts should not, however, be too ready to find the requisite degree of disproportion lest they impinge on the parties' freedom to settle for themselves the rights and liabilities following a breach of contract. The doctrine of penalties answers, in situations of the present kind, an important aspect of the criticism often levelled against unqualified freedom of contract, namely the possible inequality of bargaining power. In this way the Courts strike a balance between the competing interests of freedom of contract and protection of weak contracting parties: see generally Atiyah, The Rise and Fall of Freedom of Contract [1979], esp . Ch . 22.

It should not be assumed that, in this passage of their judgment, Mason and Wilson JJ. were setting out some broader discretionary approach than that indicated as being appropriate by Lord Dunedin. On the contrary, earlier in their judgment they had noted that the "*Dunlop* approach" had been eroded by recent decisions and they stated that there was much to be said for the view that the Courts should return to that approach. This is confirmed by the later decision of the Australian High Court in *Esanda Finance Corporation Ltd. v. Plessnig* [1989] ALJ 238. In that case, it should be noted that, according to the head note, the first holding was that, as "it had not been shown that the amount claimed ... was out of all proportion to, or extravagant or unconscionable in comparison with, the greatest loss that could conceivably be proved to have followed from the breach, a basic test for the existence of a penalty had not been satisfied". Wilson J. in giving the first judgment with Toohey J. cited, with implicit approval, the view of Dickson J. in the Supreme Court of Canada in *Elsey v. J.G. Collins Insurance Agencies Ltd.* [1978] 83 DLRI at p. 15 where he said:

> It is now evident that the power to strike down a penalty clause is a blatant interference with freedom of contract and is designed for the sole purpose of providing relief against oppression for the party having to pay the stipulated sum. It has no place where there is no oppression.

Such views are in accord with those expressed by Lord Justice Diplock in *Robophone Facilities Ltd. v. Blank* [1966] 1 WLR 1428. He said (at p. 1447) that the "Court should not be astute to descry a 'penalty clause'". These statements assist by making it clear that the Court should not adopt an approach to provisions as to liquidated damages which could, as indicated earlier, defeat their purpose.

Except possibly in the case of situations where one of the parties to the contract is able to dominate the other as to the choice of the terms of a contract, it will normally be insufficient to establish that a provision is objectionably penal to identify situations where the application of the provision could result in a larger sum being recovered by the injured party than his actual loss. Even in such situations so long as the sum payable in the event of non-compliance with the contract is not extravagant, having regard to the range of losses that it could reasonably be anticipated it would have to cover at the time the contract

was made, it can still be a genuine pre-estimate of the loss that would be suffered and so a perfectly valid liquidated damage provision. The use in argument of unlikely illustrations should therefore not assist a party to defeat a provision as to liquidated damages. As the Law Commission stated in Working Paper No. 61 (p. 30):

> The fact that in certain circumstances a party to a contract might derive a benefit in excess of his loss does not ... outweigh the very definite practical advantages of the present rule upholding a genuine estimate, formed at the time the contract was made of the probable loss.

A difficulty can arise where the range of possible loss is broad. Where it should be obvious that, in relation to part of the range, the liquidated damages are totally out of proportion to certain of the losses which may be incurred, the failure to make special provision for those losses may result in the "liquidated damages" not being recoverable. (See the decision of the Court of Appeal on very special facts in *Ariston SRL v. Charly Records Ltd.* [1990] The Independent 13th April 1990). However the Court has to be careful not to set too stringent a standard and bear in mind that what the parties have agreed should normally be upheld. Any other approach will lead to undesirable uncertainty especially in commercial contracts.

The case for the appellant.

In seeking to establish that the sum described in the Philips contract as liquidated damages was in fact a penalty, Philips has to surmount the strong inference to the contrary resulting from its agreement to make the payments as liquidated damages and the fact that it is not suggesting in these proceedings that the sum claimed is excessive in relation to the actual loss suffered by the Government. The fact that the issue has to be determined objectively, judged at the date the contract was made, does not mean what actually happens subsequently is irrelevant. On the contrary it can provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made. Likewise the fact that two parties who should be well capable of protecting their respective commercial interests agreed with the allegedly penal provision suggests that the formula for calculating liquidated damages is unlikely to be oppressive. The position is similar in relation to the evidence relied on by the Government in this case as to their reasons for seeking to quantify their loss in the manner set out in the contract. As the test is objective such evidence is far from conclusive but it can at least provide the explanation as to why the particular formula was adopted so that the Court can evaluate that explanation. Thus as Lord Justice Diplock also stated in the *Robophone* case (at p. 1447):

> The onus of showing that such a stipulation is a 'penalty clause' lies upon the party who is sued upon it. The terms of the clause may themselves be sufficient to give rise to the inference that it is not a genuine estimate of damage likely to be suffered but is a penalty. Terms which give rise to such an inference are discussed in Lord Dunedin's speech in *Dunlop Pneumatic Tyre Co. v. New Garage & Motor Co.* [1915] AC 79, 87. But it is an inference only and may be rebutted. Thus it may seem at first sight that the stipulated sum is extravagantly greater than any loss which is liable to result from the breach in the ordinary course of things, i.e., the damages recoverable under the so-called 'first rule' in *Hadley v. Baxendale* [1854] 9 Exch. 341. This would give rise to the *prima facie* inference that the stipulated sum was a penalty. But the plaintiff may be able to show that owing to special circumstances outside 'the ordinary course of things' a breach in those special circumstances would be liable to cause him a greater loss of which the stipulated sum does represent a genuine estimate.

Here the Government in its evidence provides an explanation as to how the liquidated damages were calculated. So far as the missing of Key Dates was concerned, the amount of damages was calculated by applying a formula to what was anticipated would be the value of the interfacing contracts. (The actual value of the contracts was higher.) In the case of delay in completion of the whole of the Philips contract the calculation was partly based on a formula applied to the total value of the Philips contract in accordance with a manual of instructions for contracts of this nature which the Government had prepared. This was a perfectly sensible approach in a situation such as this where it would be obvious that substantial loss would be suffered in the event of delay but what that loss would be would be virtually impossible to calculate precisely in advance. In the case of a governmental body the nature of the loss it

will suffer as the result of the delay in implementing its new road programme is especially difficult to evaluate. The Government reasonably adopted a formula which reflected the loss of return on the capital involved at a daily rate, to which were added figures for supervisory staff costs, the daily actual cost of making any alternative provision and a sum for fluctuations. Except for the "alternative provision", the appropriate figures were calculated by reference to the estimated final contract sum.

Philips argues this approach falls down because wholly unfairly it can and most probably will result in the Government receiving at least double compensation. It is suggested that this can happen because the Government will receive liquidated damages both for the delay which causes a Key Date to be missed and again when the same delay results in the date for completion not being met. It is suggested it can also happen as a result of the same delay causing two or more Key Dates to be missed. (Liquidated damages will continue to be paid in respect of the earlier Key Date after the later date is missed). As to the first example, the Government's response is that the two categories of liquidated damages are to cover different heads of loss so it is perfectly proper for payments to be made under each head. Where a Key Date is missed, the loss to which the liquidated damages primarily relate is the added expense to which the Government will be put in compensating the interfacing contractor whose contract is delayed. It is for this reason that the figure for liquidated damages is calculated on the value of the interfacing contract or contracts and accordingly increases with the number of those contracts which would be affected by the date being missed.

This is a quite different head of loss from that already described which is covered by the liquidated damages payable for missing the date for completion. Philips contest this justification because they do not accept that their default could result in another contractor having a claim against the Government. They rely on clause 28.5 of the contract which provides:

> 28.5 Any extension of time granted by the Engineer to the Contractor shall, except as provided elsewhere in the Contract, be deemed to be in full compensation and satisfaction for and in respect of any actual or probable loss or injury sustained or sustainable by the Contractor in respect of any matter or thing in connection with which such extension shall have been granted and every extension shall exonerate the Contractor from any claims or demands on the part of the Employer for or in respect of any delay during the period of such extension but no further or otherwise nor for any delay continued beyond such period.

However that clause is applicable "except as provided elsewhere" and, as would be expected, there are provisions where the other contractor can be protected in respect of delay for which Philips are responsible contained in the contract (see for example clause 33.1) which will result in expense payable by the Government. In addition any tendency for there to be an overlap is reduced because the liquidated damages for delay in completion are not based on the value of all the contracts but only the Philips contract. So, if the missing of a Key Date results in another contractor not finishing his contract in time, any loss resulting from this will not be covered other than by the "Key Date" liquidated damages. As for the Government receiving liquidated damages cumulatively for more than one missed Key Date, which could happen on the proper interpretation of the Philips contract, there is nothing necessarily unreasonable in this since as each Key Date passes additional loss may be suffered by the Government as a result of compensation of a different nature becoming payable, either to the same contractor or other contractors.

Philips also rely on two other points to establish the provisions were penal. The first was that the provisions should be assumed to be penal because, in the words of Lord Watson in *Dunlop (supra)* at p. 94,

> a single lump sum is made payable ... on the occurrence of one or more or all of several events ...

However a different situation exists here to which the presumption does not apply. In this case the only event giving rise to the liability to pay liquidated damages is delay. Although that delay may be caused by any number of different circumstances, this is not a case of different causes of loss being compensated by

the same figure of liquidated damages. As Kay LJ said in *Law v. Local Board of Redditch (supra)* at p. 136:

> There may be different causes of non-completion, but non-completion is only one single event.

The second point arises due to the presence of the minimum payment provision. The argument is based on the judgment of Sears J. in *Arnhold* which Mayo J. followed in this case. There can conceivably be circumstances where it is so obvious, before completion of the works as a whole, that the actual loss which will be sustained will be less than a specified minimum figure that to include that minimum figure in a provision for the payment of liquidated damages on a reducing sliding scale will have the effect of transforming an otherwise perfectly proper liquidated damages provision into a penalty, in so far as it prevents the liquidated damages from being reduced below that figure. However this is certainly not such a case and, so far as it is possible to ascertain the facts from the report which is available, nor was *Arnhold*.

To conclude otherwise involves making the error of assuming that, because in some hypothetical situation the loss suffered will be less than the sum quantified in accordance with the liquidated damage provision, that provision must be a penalty, at least in the situation in which the minimum payment restriction operates. It illustrates the danger which is inherent in arguments based on hypothetical situations where it is said that the loss might be less than the sum specified as payable as liquidated damages. Arguments of this nature should not be allowed to divert attention from the correct test as to what is a penalty provision - namely is it a genuine pre-estimate of what the loss is likely to be? - to the different question, namely are there possible circumstances where a lesser loss would be suffered? Here the minimum payment provision amounted to about 28% of the daily rate of liquidated damages payable for non-completion of the whole works by Philips. The Government point out that if there is delay in completion it will continue inevitably to incur expenses of a standing nature irrespective of the scale of the work outstanding and that those expenses will continue until the work is completed. This being a reasonable assumption and there being no ground for suggesting that the minimum payment limitation was set at the wrong percentage, its presence does not create a penalty.

Finally it is contended that the manner in which the liquidated damages provisions are expressed in the contract results in such uncertainty as to the manner in which they were intended to operate that they are unenforceable. This contention is also misconceived. The effect of the provisions could have been drafted with greater clarity, but their meaning can be ascertained and therefore relied on by the Government.

Notwithstanding the able argument of Mr. Dennys QC on behalf of Philips, their Lordships will therefore humbly advise Her Majesty that this appeal should be dismissed. The appellant must pay the respondent's costs before their Lordships' Board.

the same figure of liquidated damages. As Kay LJ said in *Law v. Local Board of Redditch (supra)* at p. 136:

> There may be different causes of non-completion, but non-completion is only one single event.

The second point arises due to the presence of the minimum payment provision. The argument is based on the judgment of Sears J. in *Arnhold* which Mayo J. followed in this case. There can conceivably be circumstances where it is so obvious, before completion of the works as a whole, that the actual loss which will be sustained will be less than a specified minimum figure that to include that minimum figure in a provision for the payment of liquidated damages on a reducing sliding scale will have the effect of transforming an otherwise perfectly proper liquidated damages provision into a penalty, in so far as it prevents the liquidated damages from being reduced below that figure. However this is certainly not such a case and, so far as it is possible to ascertain the facts from the report which is available, nor was *Arnhold*.

To conclude otherwise involves making the error of assuming that, because in some hypothetical situation the loss suffered will be less than the sum quantified in accordance with the liquidated damage provision, that provision must be a penalty, at least in the situation in which the minimum payment restriction operates. It illustrates the danger which is inherent in arguments based on hypothetical situations where it is said that the loss might be less than the sum specified as payable as liquidated damages. Arguments of this nature should not be allowed to divert attention from the correct test as to what is a penalty provision - namely is it a genuine pre-estimate of what the loss is likely to be? - to the different question, namely are there possible circumstances where a lesser loss would be suffered? Here the minimum payment provision amounted to about 28% of the daily rate of liquidated damages payable for non-completion of the whole works by Philips. The Government point out that if there is delay in completion it will continue inevitably to incur expenses of a standing nature irrespective of the scale of the work outstanding and that those expenses will continue until the work is completed. This being a reasonable assumption and there being no ground for suggesting that the minimum payment limitation was set at the wrong percentage, its presence does not create a penalty.

Finally it is contended that the manner in which the liquidated damages provisions are expressed in the contract results in such uncertainty as to the manner in which they were intended to operate that they are unenforceable. This contention is also misconceived. The effect of the provisions could have been drafted with greater clarity, but their meaning can be ascertained and therefore relied on by the Government.

Notwithstanding the able argument of Mr. Dennys QC on behalf of Philips, their Lordships will therefore humbly advise Her Majesty that this appeal should be dismissed. The appellant must pay the respondent's costs before their Lordships' Board.